



# Economic Update

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## Growth Expected to Rebound from Disappointing 4<sup>th</sup> Quarter

### Overview

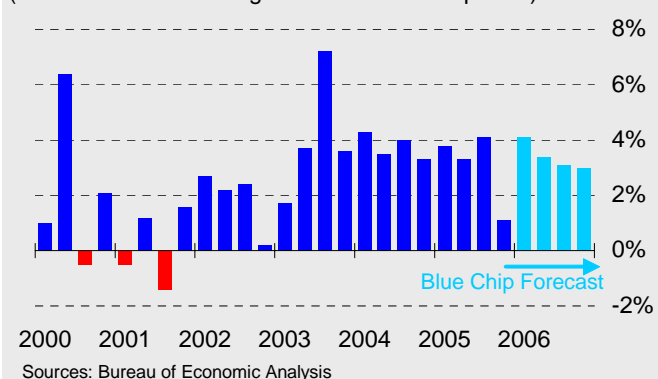
Despite a considerable 4<sup>th</sup>-quarter slowdown in growth, the U.S. economy expanded at a robust 3.5-percent rate for all of last year. Forecasters see a sharp rebound of economic growth in the current quarter, and robust growth throughout the year. They also project a further pickup in job growth this year, with historically low unemployment, and continued low inflation and interest rates.

### Highlights

- Following 4.1 percent 3rd-quarter growth in 2005, annualized growth in the inflation-adjusted (real) gross domestic product [GDP] fell to a below-trend rate of 1.1 percent in the 4<sup>th</sup> quarter. The disappointing performance resulted from a combination of factors, discussed below, and it broke a 10-quarter string of growth at 3.3 percent or more. Nevertheless, forecasters believe that the economy is poised for an above-trend rate of 4.1 percent growth this quarter (Fig. 1).
- Labor market indicators show a solid foundation for the economy at the start of the year. Non-farm payroll employment rose by 193,000 new jobs in January, and payroll gains in the prior four months were revised up by a cumulative 124,000 (Fig. 2, next page). The unemployment rate fell to 4.7 percent last month, the lowest since July 2001.
- The Federal Reserve, noting that the economic expansion remains “solid,” raised its target overnight interest rate at the end of last month by a quarter percent, to 4.5 percent. This marked the 14<sup>th</sup> quarter-point increase in a credit-tightening campaign that began in late June of 2004. Despite the hikes in short-term interest rates, long-term rates have remained relatively low.

### Economic Growth Since 2000

(Real annualized GDP growth rate in each quarter)



### Blue Chip Economic Outlook, January 2006

	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	<i>Actual</i>				<i>Projection</i>			
<b>Real GDP Growth</b>	3.8	3.3	4.1	1.1	4.1	3.4	3.1	3.0
<b>Unemployment Rate</b>	5.2	5.1	5.0	4.9	4.9	4.9	4.9	4.9
<b>CPI Inflation</b>	2.5	4.0	5.3	3.1	2.2	2.4	2.3	2.4
<b>3-month Treas. Bill</b>	2.5	2.9	3.4	3.8	4.4	4.6	4.7	4.7
<b>10-year Treas. Note</b>	4.3	4.2	4.2	4.5	4.6	4.8	4.9	4.9

### Growth Expected to Rebound from 4<sup>th</sup> Quarter

GDP, a broad measure of the Nation's output of goods and services, grew at a disappointing 1.1 percent rate in the 4<sup>th</sup> quarter of last year, held down by a number of factors, most of which analysts believe are likely to prove transitory.

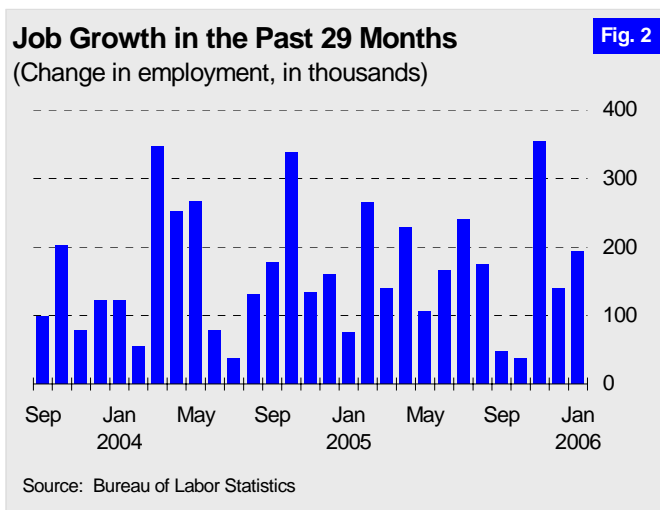
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The slowdown in growth from the rapid 4.1-percent rate posted in the 3<sup>rd</sup> quarter largely reflected slower growth in consumer spending – which accounts for roughly 70 percent of GDP – especially spending on vehicles. Growth also was held down by a downturn in Federal Government spending, slower growth in business investment in equipment and software, a slowdown in residential investment, and an acceleration in imports. Growth in imports subtracts from growth in gross *domestic* product; and in this case, much of it reflected a spike in the cost of energy imports.

The *Blue Chip* forecast – a monthly consensus of private forecasters – is for growth in real GDP to surge to a rapid 4.1 percent this quarter, followed by a return toward robust trend-like growth between 3.4 percent and 3.0 percent.

### Employment Increases, Unemployment Falls

As noted, payroll employment rose by 193,000 jobs in January, following an average monthly gain of 247,000 in the final two months of last year. There have been 29 consecutive months of job gains, adding 4.8 million new jobs to the Nation's payrolls. Over the past year, payroll jobs have grown by 2.1 million. The *Blue Chip* consensus forecast is for payroll employment to expand by an average 181,000 new jobs per month this year, up from the monthly average of 165,000 last year.



The unemployment rate fell to 4.7 percent in January from 4.9 percent in December, the second consecutive monthly decline. The current 4.7 percent unemployment rate is the lowest since July 2001 and is significantly lower than the near-term peak of 6.3 percent in June 2003. Over the past

year, the unemployment rate has declined by half a percentage point.

### Expansion Continues in Manufacturing, Services

The Institute for Supply Management [ISM] index of *manufacturing* activity edged down in January to 54.8, from 55.6 a month earlier, indicating continued expansion in the manufacturing sector, but at a slightly slower pace. An index value above 50 indicates expansion in the manufacturing sector. The ISM *services* index also edged down in January, to 56.8 from a value of 61.0 in December. The ISM services index has been above 50 for 34 consecutive months of expansion. The services sector of the economy accounts for a majority of the Nation's output

### Fed Expected to Continue Raising Short-Term Rates

Markets expect that the Federal Reserve will continue its recent course of monetary policy by increasing short-term interest rates again by a quarter percent at its policymaking meeting scheduled for March 28. The Fed has raised its target overnight interest rate from 1.00 percent to the current 4.50 percent in a sequence of quarter-point increases that began at the end of June 2004.

### Consumer Confidence Rebounds After Hurricane Lull

Measures of consumer confidence compiled by the University of Michigan and by the private Conference Board have recovered from a lull that followed the Gulf Coast hurricanes and related spikes in energy costs. In January, the Conference Board's Consumer Confidence Index rose to its highest level in more than 3 years.

#### Upcoming Indicators

**Inflation** - The Consumer Price Index for January is scheduled to be released on *February 22*.

**GDP** - The second look at GDP for the 4<sup>th</sup> quarter is scheduled for release on *February 28*.

**Employment** - The Bureau of Labor Statistics reports the February employment situation on *March 10*.

**Federal Reserve** - The Fed's next monetary policymaking meeting is scheduled for *March 28*.

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